

MEMO# 32668

August 11, 2020

China Launches Consultation on Revising Public Fund Manager Regulations

[32668]

August 11, 2020 TO: ICI Global Members

ICI Global Pacific Chapter

ICI Global Regulated Funds Committee

ICI Global Regulated Funds Committee - Asia SUBJECTS: Compliance

Distribution

International/Global

Investment Advisers

Operations RE: China Launches Consultation on Revising Public Fund Manager Regulations

On 31 July 2020, the China Securities Regulatory Commission (CSRC) released for public consultation the *Measures for the Supervision and Administration of Managers of Publicly Offered Securities Investment Funds (Consultation Paper)*[\[1\]](#)(Measures) outlining the proposed revisions to regulations governing public fund managers operating in China. The CSRC released a draft of the proposed Implementation Provisions together with the Measures. The drafts are open for public comment until 30 August 2020.

Major proposed changes in the Measures will:

1. Adopt one common regulatory framework for all managers offering public funds;
2. Introduce new classification and qualification requirements for shareholders of fund management companies licensed by the CSRC to offer mutual funds to the public (FMCs);
3. Further relax the “One Control, One Participation” (1+1) policy;
4. Strengthen governance and internal control requirements; and
5. Raise thresholds for FMCs when setting up branches and subsidiaries.

The existing regulatory framework that governs FMCs were first introduced in 2004 and last updated in 2012. The Measures take into account the evolving changes in the operating environment and are intended to create a comprehensive regime to regulate fund management companies that offer funds to the public, and shareholders of these companies.

The changes introduced under the Measures would likely have implications for global asset

managers planning to establish FMCs in China as explained below.

Unifying Regulatory Framework for Public Fund Managers

The Measures will apply to all institutions that are licensed by the CSRC to engage in management of publicly offered investment funds. Currently, apart from FMCs, there are other types of fund management companies that engage in the business of asset management and that have been granted a license by the CSRC to manage publicly offered mutual funds. These entities include asset management subsidiaries of securities companies, insurance companies, and commercial banks, and private investment fund managers who are registered with the Asset Management Association of China (AMAC).^[2] For historical reasons, these entities hold their licenses to manage publicly offered funds under different rules and regulations administered by the CSRC. For ease of reference, these entities shall be referred to as PFMCs; this memo collectively refers to FMCs together with PFMCs as Public Fund Companies.

While parts of the Measures (e.g., on shareholder qualification requirements, shareholding structure and lock-up periods, minimum number of independent directors, setting up subsidiaries) govern FMCs only, much of the Measures apply to all Public Fund Companies.

Introducing New Classification and Qualification Requirements for FMCs Shareholders

FMC shareholders are classified into three categories:

1. The largest shareholder who holds over 5% equity in the FMC (Primary Shareholder);
2. Shareholders each holding over 5% equity but who are not the Primary Shareholder (Non-Primary Shareholders); and
3. All other shareholders each holding less than 5% equity.^[3]

All FMC shareholders must show that in the past three years they have clean integrity records and no records of gross violations of law or regulation. Similarly, those who are under any current investigation for suspected material breach or misconduct or are undergoing a process of rectification will not qualify as a shareholder.^[4]

For Primary and Non-Primary Shareholders, the Measures impose additional requirements. Non-Primary Shareholders must have net assets of not less than RMB 100 million in the recent year, with good asset quality, financial health, corporate governance, internal controls and risk management, and have the ability to promote the FMC's overall competitiveness.^[5] If a Primary Shareholder is a corporation, it must be an institution with experience in financial asset or financial institution management, with net assets of not less than RMB 200 million. It must have been in operation for more than three consecutive fiscal years and have continued to show profits in the most recent three fiscal years. Its investment in the FMC must be in accord with the shareholder's own long-term strategy. A Primary Shareholder must have a feasible plan in place for improving corporate governance and promoting the long-term development of the FMC. Moreover, the Primary Shareholder must be in a position to provide continuous capital/liquidity support to the FMC appropriate for the FMC's business and operational needs, and contingency plans for situations when the FMC may not be able to operate adequately.^[6]

For overseas shareholders of FMCs holding over 5% equity, the Measures impose additional requirements. The overseas shareholder must show that it has good business performance, enjoys a good reputation internationally, that globally it ranks at the top in the size of its financial assets management, revenue, profit and market share, and that in the last three

years its long-term credit has been maintained at a high level. Furthermore, the shareholder must show that, in the recent three years, it has been in full compliance with the laws and regulations of its home country and it is located in a country or jurisdiction where its home regulator has entered into a Memorandum of Understanding with the CSRC.[\[7\]](#)

Relaxing “One Control, One Participation” Policy

The Measures will further relax the “One Control, One Participation” (1+1) policy. Under this policy, a shareholder can wholly or majority own one FMC and at the same time own/control a minority stake in another FMC, provided that the two companies have complete Chinese walls, each with separate management teams and separate boards (no directors or senior managers in either company holds concurrent positions), and there is no sharing of systems or information, etc. The Measures will extend the 1+1 policy to a “One Control, One Participation, One License” policy, under which a shareholder is allowed to wholly or majority-own two Public Fund Companies, of which one can be an FMC, and at the same time hold a minority stake in another FMC.[\[8\]](#) In other words, within its same group company in China, a global asset manager may now have up to three companies with CSRC public fund licenses – one wholly or majority owned FMC, one minority owned FMC, and one wholly or majority owned PFMF.

Strengthening Requirements on Governance and Internal Controls

The Measures provide that Public Fund Companies shall appoint independent directors, with at least one independent director sitting on each board committee. An independent director must be a person who is competent and experienced in the industry with a clean integrity record and no gross violation of laws or regulations record in the last five years.[\[9\]](#) For an FMC, the independent director requirement appears to be more strict. It must appoint a minimum of three independent directors and in any event at least one-third of its board members must be independent directors. Where over 50% of the equity interest in an FMC is owned or controlled by one shareholder either singly or together with its associated entity, at least 50% of the FMC’s board members must be independent directors.[\[10\]](#)

Major associated transactions, audit matters, appointment or change of auditors, key business innovations, and major changes in a Public Fund Company’s organizational structure must be examined by the board and passed by a vote of at least two-thirds in number of all independent directors.[\[11\]](#) Public Fund Companies are required to disclose in reports within three months from the end of each fiscal year information on the discharge of duties including voting by its independent directors. Independent directors should report to the CSRC if a Public Fund Company has failed to disclose any such information.[\[12\]](#)

The Measures will lengthen the equity lock-up period for FMC shareholders. For Primary Shareholders, the lock-up will be extended from 36 to 48 months. Non-Primary Shareholders will be subject to a 36-month lock-up.[\[13\]](#) The lock-up covers not only the sale but also the pledging of equity. Even after the lock-up period has expired, shareholders will not be permitted to pledge their equity to non-financial institutions and the percentage of pledged shares shall not exceed 50% of their total shareholding in the FMC.[\[14\]](#)

Enhancing Requirements on FMCs in Setting Up Branches and Subsidiaries

The Measures specify that, upon approval from the CSRC, subsidiaries of FMCs may engage in asset management-related businesses, including managing publicly offered funds, engaging in privately offered asset management business, investment advisory, and

distribution of financial products.^[15] To prevent disorderly expansion, an FMC will not be granted approval if it has violated any material regulatory measures in the last three years, or is currently under investigation for suspected material breach or misconduct, or undergoing a process of rectification. In principle, the subsidiary should be wholly owned by the FMC.^[16] The FMC must have net assets of not less than RMB 600 million and, in the last two years, the daily average AUM of all its actively managed equity funds should be no less than RMB 20 billion. It should also have a risk reserve with a minimum of RMB 200 million.^[17]

An FMC shall have a centralized and uniform management system to manage its branches and subsidiaries, including the business activities, compliance management, risk management control, information technology system, and employee performance appraisals.^[18] The FMC is required to establish a Chinese wall to separate the business activities among its subsidiaries, and between its subsidiaries and itself.^[19]

Alexa Lam
Chief Executive Officer, Asia Pacific
ICI Global

Irene Leung
Regional Lead, Member Relations and Research, Asia Pacific
ICI Global

Lisa Cheng
Research Analyst
ICI Global

endnotes

^[1] The Measures (in Chinese) are *available at* http://www.csrc.gov.cn/pub/zjhpublish/zjh/202007/t20200731_380932.htm.

^[2] See Measures, Chapter 1, clause 2.

^[3] See Measures, Chapter 2, clause 7.

^[4] See Measures, Chapter 2, clause 8.

^[5] See Measures, Chapter 2, clause 9.

^[6] See Measures, Chapter 2, clause 10.

^[7] See Measures, Chapter 2, clause 13.

^[8] See Measures, Chapter 2, clause 15.

^[9] See Measures, Chapter 4, clause 32.

^[10] See Measures, Chapter 4, clause 30.

[\[11\]](#) See Measures, Chapter 4, clause 33.

[\[12\]](#) See Measures, Chapter 4, clause 34.

[\[13\]](#) See Implementation Provisions, Chapter 3, clause 11.

[\[14\]](#) See Measures, Chapter 4, clause 28.

[\[15\]](#) See Measures, Chapter 5, clause 39; Implementation Provisions, Chapter 3, clause 17.

[\[16\]](#) See Measures, Chapter 5, clause 41.

[\[17\]](#) See Implementation Provisions, Chapter 3, clause 19.

[\[18\]](#) See Measures, Chapter 5, clause 42.

[\[19\]](#) See Measures, Chapter 5, clause 43.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.